SUPREME COURT OF KENTUCKY
NO. 2012-SC-000626-D
(2010-CA-001185-MR AND 2010-CA-001266-MR)

COMMONWEALTH OF KENTUCKY On Behalf of
the COMMERCIAL MOBILE RADIO EMERGENCY
SERVICE TELECOMMUNICATIONS BOARD,
APPELLANT/APPELLEE,

v.

ON DISCRETIONARY REVIEW FROM
COURT OF APPEALS
NOS. 2010-CA-001185 AND 2010-CA-001266

VIRGIN MOBILE U.S.A., L.P.,
APPELLEE/APPELLANT.

RESPONSE BRIEF FOR APPELLEE VIRGIN MOBILE U.S.A., L.P.

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CERTIFICATE OF SERVICE

It is hereby certified that a true and correct copy of the following Response Brief for Appellee Virgin Mobile U.S.A., L.P. was served by first class mail, postage prepaid, this 13th day of September 2013 on: Jonathan D. Goldberg, Jan M. West, Jennifer K. Luhrs, Goldberg Simpson, LLC, 9301 Dayflower Street, Prospect, KY 40059; Mark A. Loyd , John K. Bush, Bingham Greenebaum Doll LLP, 3500 National City Tower, 101 South Fifth Street, Louisville, KY 40202; Sheryl G. Snyder, Thomas P. O'Brien, III, Cory J. Skonick, Frost Brown Todd LLC, 400 West Market Street, 32nd Floor, Louisville, KY 40202; Hon. James M. Shake and Hon. F. Kenneth Conliffe, Jefferson Circuit Court, Judicial Center, 700 West Jefferson Street, Louisville, KY 40202; and Clerk, Ky. Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601

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ABBREVIATIONS

CMRS	Commercial Mobile Radio Service
CMRS Act	Commercial Mobile Radio Service Emergency Telecommunications Act, KRS 65.7621 to 65.7643.
CMRS Board, the Board	Commercial Mobile Radio Service Emergency Telecommunications Board of the Commonwealth of Kentucky
CMRS Fund	Commercial Mobile Radio Service Emergency Telecommunications Fund
CMRS Service Charge	Commercial Mobile Radio Service Emergency Telephone Service Charge levied under KRS 65.7629(3) and collected under KRS 65.7635
Lucas depo.	Deposition of David Lucas, Chairman, Commercial Mobile Radio Service Telecommunication Board of the Commonwealth of Kentucky
Op.	Opinion by the Court of Appeals below
R.	Record
Virgin Mobile	Virgin Mobile U.S.A., L.P.
Wagner depo.	Deposition of Gary Wagner, Vice President of Tax and Regulatory Compliance for Virgin Mobile U.S.A., L.P.

STATEMENT CONCERNING ORAL ARGUMENT

Virgin Mobile agrees that oral argument will assist the Court in understanding the overarching issues relating to the distinct pre- and post-2006 versions of the CMRS Act, as applied to prepaid wireless service customers, and Virgin Mobile's good faith challenge to the CMRS Board's lawsuit.

COUNTERSTATEMENT OF POINTS AND AUTHORITIES

COUNTERSTATEMENT OF THE CASE

Appellee does not accept the Appellant's Statement of the Case. This case involves a good faith dispute over whether a particular version of a taxing statute applies to a particular class of citizens in the state of Kentucky. It is undisputed that there was genuine confusion and uncertainty about whether the pre-2006 version of the 911 taxing statute, CMRS Act, KRS 65.7621-7643, applied to customers for incipient "prepaid" wireless services like those offered by Virgin Mobile. Not only was there confusion and uncertainty among wireless service providers told to collect the tax from those customers, there was also confusion within the CMRS Board, the agency tasked with the application and enforcement of the statute. Indeed, the uncertainty continues.

Nonetheless, the Jefferson Circuit Court granted summary judgment in favor of the CMRS Board and ordered Virgin Mobile to pay the CMRS Board's attorney's fees. The Court of Appeals affirmed the underlying judgment but reversed the award of attorney's fees. Virgin Mobile has appealed the judgment in favor of the CMRS Board in a concurrent appeal, *see Virgin Mobile U.S.A., L.P. v. Commonwealth of Kentucky*, No. 2012-SC-000621, and the CMRS Board here appeals the reversal of the attorney's fee award. Importantly, this appeal becomes ripe for decision only if the Court of Appeals' judgment on the merits is affirmed. If this Court reverses the underlying judgment on the merits, there is not even a potential basis for an award of attorney's fees to the CMRS Board and this appeal, accordingly, is moot.

As this appeal ties directly to a question of statutory interpretation, the exact words of the statute matter, not only as to the merits (in a separate appeal) but for the issue here: whether a taxpayer has any realistic opportunity to question in good faith the

applicability of such an ambiguous tax statute. Yet the agency's brief mischaracterizes the enabling legislation at issue and fundamentally so. CMRS Br. 3 (omitting "monthly" from originally enacted version of KRS 65.7635(1)).[1] The CMRS Board would subject involuntary, reluctant collection agents like Virgin Mobile to an untenable choice: abandon a reasonable and good-faith challenge or advance it with the knowledge that to lose is to shoulder not only one's own attorney's fees, but those of the government as well. The Court of Appeals properly protected against this Morton's Fork dilemma, finding that a dispute brought in good faith, such as the challenge here, obviates an award of attorney's fees under the CMRS Act.

The Circuit Court abused its discretion in awarding such attorney's fees without analysis or fact findings supporting such an award. The Court of Appeals' reversal of the award was proper both on the basis of Virgin Mobile's good faith dispute and based on the plain language of the provision at issue. Understanding the good faith dispute requires an overview of how the statute has been twice amended to address changes in the telecommunications business.

I. HISTORY OF THE CMRS ACT

For decades the General Assembly has permitted a government-determined charge on telephone services in order to fund 911 emergency services. Customers using fixed local exchange services pay charges of varying amounts, depending on what has been set under a local ordinance. The telecommunications industry does not pay this tax, it merely collects it. And the taxing mechanism and scope has changed over time to

[1] KRS 65.7635(1) was enacted in 1998. 1998 Ky. Acts Ch. 535, Section 8(1).

address changes in telephone technology and collection methods.[2] Most importantly, as wireless telephones gained popularity, the General Assembly devised a geographically uniform, statewide 911 service charge collection process that would apply only to mobile services, the CMRS Act. *See* KRS 65.7621-7643 (enacted in 1998). To avoid the possibility that wireless customers would be billed for both the state-imposed tax of seventy cents per month and the locally-imposed tax permitted by KRS 65.760, the General Assembly preempted the application of local 911 ordinances to wireless services by enacting KRS 65.7627, which stated, in pertinent part:

> The CMRS service charge shall have uniform application within the boundaries of the Commonwealth. No charge other than the CMRS service charge is authorized to be levied by any person or entity for providing wireless 911 service or wireless E911 service.

Id.

Establishment of the CMRS Service Charge provided a geographically uniform tax on customers, but the collection method set forth in the original statute, even as amended in 2002, was written to extend only to wireless providers that used a regular monthly billing process and could collect the state-imposed tax as a line item on their customer bills. By doing so, the General Assembly imposed a 911 tax in a manner consistent with how traditional local telephone service providers had collected locally-imposed 911 taxes.

Critically, the 1998 legislation did not account for the possibility that some wireless providers might offer services that do not include periodic billing at all. So-

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[2] A full history of 911 emergency service charge statutes is set forth in Virgin Mobile's brief in the concurrent appeal, *Virgin Mobile U.S.A., L.P. v. Commonwealth of Kentucky*, No. 2012-SC-000621

called "prepaid" services are used by funding a debit-style account with funds placed into an account and usable at the customer's discretion to purchase wireless services by the minute, and not necessarily by the month, but always on a pay-as-you-go-basis. That service offering is distinguishable from the more widely utilized and commonly understood postpaid wireless services generally sold for a monthly price and billed in arrears. The postpaid, monthly model was by far the most common wireless service model in 1998. (Lucas depo. at 73-74).

Along with its 1998 enactment of the CMRS Act, KRS 65.7621-65.7643, the General Assembly established the CMRS Board (Appellant) to manage a "CMRS Fund" that supports wireless 911 service in Kentucky. (R. 3). The CMRS Fund is funded by the levy of a CMRS Service Charge under KRS 65.7629. (R. 110). When the charge applies to a wireless user, wireless carriers are the collection agents for the state. (R. 3). Indeed, as the collection agents, the wireless carriers are allowed to keep 1.5 percent of the fees they collect in exchange for their efforts. The 1998 statute contained the following mandatory collection procedure:

> Each CMRS provider shall act as a collection agent for the CMRS fund . . . [and] *shall, as part of the provider's normal monthly billing process, collect* the CMRS service charges levied upon CMRS connections under KRS 65.7629(3) from each CMRS connection to whom the *billing provider* provides CMRS. Each *billing provider* shall list the CMRS service charge as a separate entry on each *bill* which includes a CMRS service charge.

KRS 65.7635(1) (as in effect July 15, 1998 to July 11, 2006) (emphasis added).

Critically, the charge is imposed on the wireless user and the collection obligation ties directly to a provider's "normal monthly billing process" which in turn exists only for a "billing provider" of CMRS. Without a "normal monthly billing process" the ability as well as the requirement to serve as a "collection agent" is problematic, if not nonsensical.

Indeed, one court remarking on this language said "[t]he *defect in the original statute* was that the prescribed method of collection did not comport with prepaid providers' chosen business model." *Commonwealth Commercial Mobile Radio Serv. Emergency Telecomms. Bd. v. TracFone Wireless, Inc.*, 735 F. Supp. 2d 713, 724 (W.D. Ky. 2010) (emphasis added), *aff'd*, 712 F.3d 905 (6th Cir. 2013). But that is precisely why the CMRS Service charge prior to 2006 applied *only* to monthly billed wireless services, and not to all mobile services.

In July 2002, the General Assembly amended the CMRS Act as part of its adoption of the federal Mobile Telecommunications Sourcing Act ("MTSA"), 4 U.S.C. § 116-126. (Lucas depo. 87-91, R. 115). The amendment imposed the CMRS Service Charge on wireless users with a "place of primary use [as defined in the MTSA] within the Commonwealth," KRS 65.7629(3) (as in effect July 15, 2002 to July 11, 2006), authorizing the Board:

> To collect the CMRS service charge from each CMRS connection with a place of primary use, as defined in 4 U.S.C. sec. 124 [the MTSA], within the Commonwealth. The CMRS service charge shall be seventy cents ($0.70) per month per CMRS connection, and shall be collected in accordance with KRS 65.7635 . . . .

Id.

The CMRS Act provision for collection remained unchanged. It continued to mandate that billing providers collect the tax from their customers by adding it to the customers' monthly bills. *See* KRS 65.7635(1) (as in effect July 15, 1998 to July 11, 2006).

In early 2006, Governor Ernie Fletcher proposed that the General Assembly amend the CMRS Act to "clos[e]" the "tax loophole on prepaid cell phones." Press Release, Governor Ernie Fletcher's Communication Office, Governor Ernie Fletcher

Honors Kentucky's Emergency Workers During First Responders' Day (Feb. 9, 2006), *available at* http://bit.ly/924aOi. (R. 16). The Legislative Research Commission then issued a State Fiscal Note Statement on March 15, 2006. (R. 16); Commonwealth State Fiscal Note Statement, 2006 BR No. 1158, HB Bill No. 656/GA (Mar. 15, 2006), *available at* http://www.lrc.ky.gov/record/06rs/HB656/FN.doc [hereinafter Fiscal Note]. The Fiscal Note, which is based on representations from the CMRS Board, concluded that the proposed amendments to the CMRS Act were for the purpose of "clos[ing] a loophole by requiring 'prepaid' wireless phone services to pay the [CMRS] surcharge *as well*." (Fiscal Note at 1 (emphasis added)). According to the Legislative Research Commission, the prepaid "loophole" allowed prepaid wireless phone services "to not remit the [CMRS] surcharge." (*Id.* at 2.)

The Court of Appeals accurately described the legislative history:

> Consistent with Governor Fletcher's proposal . . . [t]he legislation *expressly extended* the CMRS service charge to services that *had not been included* either in the original statute enacted in 1998, or as amended to conform to the MTSA in 2002. Specifically, the General Assembly *enlarged the CMRS service charge statutes* to expressly subject even prepaid CMRS connections without a place of primary use, as defined in 4 U.S.C. § 124, to the CMRS service charge. Among other changes, KRS 65.7629(3)(b) was added to extend the CMRS service charge to "prepaid CMRS connections," and more than one hundred words were added to . . . create a formula for calculating the *newly expanded* CMRS service charge for CMRS customers who purchase CMRS service on a prepaid basis. KRS 65.7635 was also amended to reach CMRS connections without monthly billing services, *which had not been taxed* under the original version of KRS 65.7635(1).

(Op. at 7 (emphasis added)).

If the CMRS Act had always applied to all wireless services as the CMRS Board contends in this appeal, there obviously would have been no "loophole" to close. Thus,

the CMRS Board's position is reduced to this: the 2006 amendments to the CMRS Act were unnecessary because the old statutes covered prepaid services all along.

II. VIRGIN MOBILE CHALLENGED THE APPLICATION OF THE PRE-2006 CMRS ACT TO PREPAID CUSTOMERS

Unlike some wireless carriers, Virgin Mobile only provides prepaid wireless telecommunications services in the Commonwealth. (Wagner depo. 22, R. 14). Virgin Mobile's customers accordingly do not receive any bills. (Wagner depo. 23, R. 14). Unlike many wireless carriers, Virgin Mobile does not operate its own retail stores; rather, its handsets and prepaid cards are sold at retailers and on Virgin Mobile's Web site. (Wagner depo. 31-32, R. 13). During the period at issue, August 2002 until July 12, 2006, the vast majority of its customers purchased Virgin Mobile's services from independent third party retailers[3]; Web site sales accounted for no more than fifteen percent of Virgin Mobile's business. (Wagner depo. 32). Virgin Mobile, therefore, rarely had direct contact with its customers. (*Id.* at 50).

Virgin Mobile made a good faith effort to remit taxes under the pre-2006 Act beginning in August 2002 when it started doing business in the Commonwealth. (Wagner depo. 18-19). Because there was no mechanism to collect the state-determined charge from its customers, Virgin Mobile remitted charges from its own revenues and did not directly recover the expense. It continued to send money through May 2005, remitting a total of $286,807 on behalf of its customers, from its own revenues. (Wagner depo. 49, R. 15). While Virgin Mobile could not actually calculate the amount of tax allegedly due, its tax advisor, Tax Partners, kept a log of the number of active customers

[3] The period at issue starts in August 2002 when Virgin Mobile started operating in the Commonwealth and ends on July 12, 2006, the effective date of the 2006 CMRS Act.

with a Kentucky phone number in a given month. (Wagner depo. 39). Using this list, Virgin Mobile calculated the amount it estimated its customers might owe under the CMRS Act by multiplying the number of customers in a month by seventy cents and deducting the 1.5 percent administrative fee. (*Id.*)

Even these good faith efforts could not be fully compliant because no one—neither Virgin Mobile, its tax advisor, nor the CMRS Board—knew how much Virgin Mobile's customers should pay, even if the statutes were applicable to prepaid services. There is no correlation between the amount of money spent to fund future services and the actual monthly usage, if any, for a given customer. For example, a customer could buy several top-up cards at once or add money to her account and use the purchased minutes over the course of one day or several months, etc.

In early 2005, Virgin Mobile's Tax Department learned that the national tax consulting firm CCH had concluded that the CMRS Service Charge did not apply to prepaid services. (Wagner depo. 54, R. 15). Virgin Mobile also independently concluded that the CMRS Service Charge did not apply to prepaid wireless carriers in general and did not apply to the services provided by Virgin Mobile in particular. (Wagner depo 64, R. 15) Accordingly, on June 1, 2005, Virgin Mobile stopped remitting the Kentucky CMRS Service Charge and requested a refund of the $286,807 it had mistakenly submitted. (R. 16; Wagner depo. 73). On December 1, 2005, Mr. Fogel, a staff attorney at the Justice and Public Safety Cabinet, sent a letter to Virgin Mobile denying its request. (Lucas depo. 141, R. 16). There is no evidence that Virgin Mobile's

refund request was ever brought to the attention of or put to a vote by the CMRS Board. (Lucas depo. 136-41).[4]

Only after being sued by the CMRS Board did Virgin Mobile discover how uneasy the Board had been with the language of the statute. As early as 1999, CMRS Board members had considered "which [prepaid] collection methodology comes closest to supporting the intent of the Kentucky E911 legislation," and noted the "numerous impediments" to "collecting fees" in the prepaid context including what was a "billing period, as intended by the statute." (Lucas depo. 58, Exs. 6, 9 at 4). The Board even twice considered seeking the opinion of the Attorney General as to the applicability of the CMRS Service Charge to prepaid service. The Board was twice advised *not* to seek the opinion of the Attorney General and followed such advice, presumably because the CMRS Board feared an adverse opinion. (Lucas depo. at 98, 109, 116-21, Ex. 15 at 2 and Ex. 23 at 3).

On October 17, 2006, Virgin Mobile again asked the CMRS Board to apply the erroneously remitted $286,807 as a credit against the newly applicable CMRS Service Charge. (Lucas depo. 180-81, Ex. 36; R. 18). On January 23, 2007, when the CMRS Board still had not responded to Virgin Mobile's letter, Virgin Mobile sent a second letter enclosing tax returns applying a portion of the $286,807 credit in satisfaction of its liability under the new prepaid CMRS Service Charge. (Wagner depo. Ex. 26).

The CMRS Board then formally denied Virgin Mobile's requests for a refund for the first time and sued. (R. 18).

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[4] There is no issue in this case as to the applicability of the 2006 version of the CMRS Act. Virgin Mobile readily agrees that the CMRS Act, as in effect July 12, 2006, requires it to collect the tax from its customers or pay it on their behalf.

III. THE CIRCUIT COURT RULED IN FAVOR OF THE CMRS BOARD AND AWARDED ITS ATTORNEY'S FEES.

On March 24, 2010, the Jefferson Circuit Court, Honorable F. Kenneth Conliffe, held that the CMRS Service Charge was owed from the time Virgin Mobile offered its prepaid service in the Commonwealth through July 12, 2006. The Circuit Court found that the tax was imposed on users and not on providers, but that the prepaid versus postpaid distinction was "irrelevant." (R. 187). Therefore, the Circuit Court said Virgin Mobile should have collected the Service Charge even though it was "not a 'billing provider'" under the statute and "there [was] no rational way to correlate the levy and collection statutes." (R. 187, 190). The Circuit Court entered an order awarding the CMRS Board $547,945.67 in disputed CMRS Service Charges. (R. 191). The Circuit Court awarded postjudgment interest, but denied the CMRS Board's request for prejudgment interest. (R. 190-91). Erroneously considering this as an exemption case, the Circuit Court construed ambiguities (and the lack of a statutory collection mechanism) against Virgin Mobile. (R. 190).

The CMRS Board moved to alter the March 24 Order, requesting that the Circuit Court award prejudgment interest and attorneys' fees. (R. 193). On June 8, 2010, the Circuit Court, Honorable James M. Shake, awarded the CMRS Board $137,869.03 in attorneys' fees, but again denied the CMRS Board's request for prejudgment interest. (R. 253). Both Virgin Mobile and the CMRS Board appealed. (R. 255, 276).

IV. THE COURT OF APPEALS AFFIRMED THE JUDGMENT BUT REVERSED THE ATTORNEYS' FEES AWARD

The Court of Appeals offered a conflicted analysis of the pre-2006 CMRS Act's application to prepaid wireless services, acknowledging that the 2006 amendments changed the statute "to reach CMRS connections without monthly billing services, which

had not been taxed under the original version of KRS 65.7635(1)." (Op. at 7). Yet the Court of Appeals ultimately concluded that the pre-2006 Act still required Virgin Mobile to collect and remit the service charge even though it does not use a "monthly billing process" described by the plain language of the statute. (Op. at 23-24).

However, the Court of Appeals reversed the attorney's fees award, holding that "in this particular instance, this Court is of the opinion that Virgin Mobile did, in fact, dispute payment of the service charge in good faith and, accordingly, we believe the court exceeded its discretion in ordering Virgin Mobile to pay the attorney's fees of the Board." (Op. at 30). The Court of Appeals concluded that KRS 65.7635(5) authorized an award of attorney's fees, but that Virgin Mobile's "good faith [] obviate[d] penalization via an award of attorney's fees." (Op. at 31). Finally, the Court of Appeals affirmed the trial court's denial of prejudgment interest. (Op. at 34-35).

On July 19, 2012, Virgin Mobile filed a Petition for Modification or Extension of Opinion with the Court of Appeals. Virgin Mobile requested that the Court of Appeals modify or extend the opinion so that it applied prospectively from the effective date of the CMRS Act's 2006 amendments specifically referencing prepaid services. The Court of Appeals denied Virgin Mobile's petition on August 23, 2012, without issuing an opinion. This Court granted Virgin Mobile's Motion for Discretionary Review of the Court of Appeals' decision on the merits, and the CMRS Board concurrently sought review of the Court of Appeals' ruling on attorney's fees.

ARGUMENT

I. THE COURT OF APPEALS CORRECTLY REVERSED THE AWARD OF ATTORNEY'S FEES BASED ON VIRGIN MOBILE'S GOOD FAITH DISPUTE OF THE CMRS SERVICE CHARGE.

The Court of Appeals correctly found that the trial court's award of attorney's fees against Virgin Mobile constituted an abuse of discretion in light of the particular circumstances of this case. (Op. at 31.) Virgin Mobile, while fully complying with current law (as amended), has reasonably and in good faith disputed the application of the CMRS Act to prepaid wireless service transactions that occurred before July 12, 2006. Indeed, Virgin Mobile continues to dispute this issue in the appeal concurrently pending before this Court. As the Court of Appeals concluded, Virgin Mobile's good faith in challenging the pre-2006 Act "obviate[s] penalization via an award of attorney's fees[.]" (*Id.*)

A. THE COURT OF APPEALS APPLIED THE CORRECT STANDARD OF REVIEW.

The Court of Appeals' opinion demonstrates unequivocally that it analyzed the attorney's fee award for abuse of discretion. Despite the CMRS Board's assertion that the Court of Appeals applied an incorrect standard of review (CMRS Br. 11-13), the Court of Appeals' conclusion that the lower court "exceeded its discretion" in awarding attorney's fees constitutes a finding of abuse of discretion. (Op. at 31).

Indeed, it is axiomatic that a court abuses its discretion when it "exceeds" its authority or discretion. *See, e.g., Zervos v. Verizon N.Y., Inc.*, 252 F.3d 163, 169 (2d Cir. 2001) (holding that a lower court "'abuses' or 'exceeds' the discretion accorded to it when . . . its decision—though not necessarily the product of a legal error or a clearly erroneous factual finding—cannot be located within the range of permissible decisions.").

As the Second Circuit has explained, "[d]iscretion is said to be 'abused' ('exceeded' would be both a more felicitous and correct term) when the decision reached is not within the range of decision-making authority a reviewing court determines is acceptable for a given set of facts." *Zervos*, 252 F.3d at 169 n.6.

This Court has defined "discretion" of a court as "a liberty or privilege allowed to a judge, within the confines of right and justice, to decide and act in accordance with what is fair, equitable, and wholesome, as determined by the peculiar circumstances of the case . . . ." *Kuprion v. Fitzgerald*, 888 S.W.2d 679, 684 (Ky. 1994) (internal quotation omitted). The Court of Appeals' analysis and conclusions demonstrate its determination that an award of attorney's fees was inequitable and unfair here, in light of Virgin Mobile's good faith and reasonable challenge to the pre-2006 CMRS Act. (Op. at 30-31).

Contrary to the CMRS Board's hypertechnical suggestion, the Court of Appeals was not required to use certain magic language in finding an abuse of discretion. (CMRS Br. 14.) The Court of Appeals was not required to use the words "firmly convinced," "arbitrary," "unreasonable," "unfair, or unsupported" in order to avoid reversal of its judgment. To have gone beyond the boundary of discretion ("exceeded it") was an abuse of it. In any event, the Court of Appeals' analysis and conclusion make clear that it was "firmly convinced that a mistake ha[d] been made" in awarding attorney's fees against Virgin Mobile. *Walters*, 121 S.W.3d 210, (Ky. App. 2003). Its finding makes clear that the award was arbitrary, unreasonable, and unfair in the face of both Virgin Mobile's good faith and reasonable conduct, and in light of the CMRS Board's own conduct in dealing with Virgin Mobile. (Op. at 30-31).

The CMRS Board's assertion that the lower court's award must be given "substantial deference" is simply incorrect. The lower court made no factual findings in support of an award of attorney's fees that would be entitled to such deference. Thus, the CMRS Board's reliance on *Walters* , 121 S.W.3d at215 n.17, and *Imwalle v. Reliance Med. Prods., Inc.*, 515 F.3d 531, 551 (6th Cir. 2008), is misplaced. These cases simply stand for the proposition that a trial court's factual findings are entitled to deference. *See Walters*, 121 S.W.3d at 215 (factual findings for attorney's fee award under 42 U.S.C. § 1988 are "entitled to substantial deference"); *Imwalle*, 515 F.3d at 551 (deference is justified where "the rationale for the award is predominantly fact-driven").

The Circuit Court did not analyze or find that assessing attorney's fees against Virgin Mobile was justified by the particular facts in the case; it simply stated that "[a]s such an award is authorized by statute, the Court's next step is to analyze the reasonableness of the amount claimed." (R. 253.) This Court has recognized that "the fact that the trial court failed to include specific factual findings and legal conclusions to support its decision . . . could imply that the decision was arbitrary, unreasonable, or unfair, or that the trial court applied the wrong legal standard," although such failure is not automatically indicative of that conclusion. *Miller v. Eldridge*, 146 S.W.3d 909, 921 (Ky. 2004). Moreover, the mere fact that the CMRS Board prevailed on its claim below does not itself provide factual justification for awarding attorney's fees in the face of Virgin Mobile's reasonable and good faith challenge. Quite the contrary. This Court has cautioned that imposing statutory attorney's fees against good faith appellants of agency action merely because they lost on the merits may violate Section 2 of the Kentucky

Constitution. *See City of Louisville v. Slack*, 39 S.W.3d 809 (2001) (reversing fee award against employer appellant that lost on the merits in worker's compensation dispute).

B. Virgin Mobile Challenged the Pre-2006 CMRS Act in Good Faith.

The Court of Appeals concluded that "Virgin Mobile did, in fact, dispute payment of the service charge in good faith." (*Id.*) It correctly recognized that the "good faith" rule has long prevailed in Kentucky, whose courts "have repeatedly held that a good faith basis for dispute can obviate the need for assessment of attorney's fees." (Op. at 30 (citing *Commonwealth v. Cincinnati, N. O. & T. P. Ry. Co.*, 155 S.W.2d 460 (Ky. 1941); *Commonwealth v. Thomas*, 298 S.W.2d 302, 303 (Ky. 1957)). This "good faith" rule applies when a taxpayer disputes (and fails to pay) a demanded tax and "leaves for consideration the only other question as to whether or not the facts as herein before recited and which are undisputed were sufficient to justify defendant's non-payment of the taxes . . .while acting in the good faith belief" that such collection was not authorized. *Cincinnati, N.O. & T.P.*, 155 S.W.2d at 461-62.

The answer to that question here is unequivocal: Yes. Virgin Mobile acted in the good faith belief that the collection of the CMRS Service Charge was not authorized on its wireless services under the pre-2006 CMRS Act. As this Court explained in *Thomas*:

> This was a good faith controversy, and under the circumstances developed in this series of litigation, we cannot say that the taxpayer was in default to the extent that he should be required to pay penalties and interest. To impose this additional liability would be penalizing the taxpayer for exercising this right to appeal.

298 S.W.2d at 303. This long-standing principle was reaffirmed again in *Meyers v. Arcadia Realty Found., Inc.*, 367 S.W.2d 836 (Ky. 1963), which recognized that the

Court had "specifically held that the good faith of the taxpayer could be considered in determining whether he should be relieved of such penalties and interest." (*Id.* at 837.)

In addition to a losing party's "good faith," courts also properly consider other factors in determining whether to award additional fees or costs, including the difficulty of the case and the winning party's behavior. *Singleton v. Smith*, 241 F.3d 534, 539 (6th Cir. 2001) (holding that these factors can overcome even a statutory *presumption* in favor of a cost award); *Shafizadeh v. Bellsouth Mobility, LLC*, 2006 WL 1866826, at *2 (6th Cir. July 5, 2006) (not designated for publication) (affirming denial of discretionary attorney's fees in removal action because "absent unusual circumstances, attorney's fees should not be awarded when the removing party has an objectively reasonable basis for removal").

The record establishes that there was a genuine dispute about whether the pre-2006 CMRS Act applied to prepaid wireless services. The fact that the pre-2006 CMRS Act provided *no method* for calculating the tax with respect to prepaid customers, who received no billing statements but independently decided whether and how they paid for and used prepaid wireless services, created great confusion and uncertainty regarding the Act's application. The Court of Appeals recognized the existence of this genuine dispute, finding that:

> In making this determination, this Court notes that two national tax compliance services had issued opinions indicating that the Kentucky CMRS fee did not apply to prepaid cellular phones. Moreover, the record indicates that when Virgin Mobile made an attempt to discuss payment of the fee with the Board, it was rebuffed. Additionally, various other prepaid providers had taken similar actions and this led to much confusion as to the application of the statute and whether it was intended for prepaid as well as postpaid carriers.

(Op. at 30.) In addition to its own investigation and the conclusion reached by other prepaid providers, Virgin Mobile's good faith reliance on the opinions of two impartial national tax compliance services further supports the objective reasonableness of its challenge. *See Genex/London, Inc. v. Ky. Bd. of Tax Appeals*, 622 S.W.2d 499, 501 (Ky. 1981) (affirming appellate court's "wellreasoned" finding that taxpayer's good faith reliance on advice of tax counsel constituted reasonable cause for failure to file return).

But there is a further, equally compelling reason attorney's fees should not have been awarded in this case. Virgin Mobile was not simply disputing a tax on its own behalf. Virgin Mobile was caught in the middle, through no fault of its own, as a private party conscripted by the state to serve as a tax collector. The Circuit Court's award penalized Virgin Mobile for its legitimate attempt to balance its responsibilities to both the state and its customers. Virgin Mobile could not take a customer's money and hand it over simply to maintain peace with a state agency or "support" an otherwise laudable public policy when faced with a genuine dispute about the applicability of that service charge to its customers. Indeed, rolling over in the face of a legitimate dispute would place Virgin Mobile at significant risk of being whipsawed in the future by customers alleging they were wrongfully assessed.[5] Accordingly, Virgin Mobile never took a

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[5] Under the common law doctrine of constructive fraud, telecommunications providers that mistakenly collect charges at the urging of a government agency can be forced to refund any pass-through charges not clearly supported by the statute itself. Recent examples include refund litigation against Cincinnati Bell Telephone Company brought by a class of its Kentucky customers who allege it collected Kentucky sales tax on Internet access services that are not within the statutory definition of "sale" in KRS 139.120. The class alleged that by charging "a sales tax that was not owed" Cincinnati Bell committed a constructive fraud for several years. That Cincinnati Bell actually *remitted* the tax has not made a difference—after three years in federal court, Cincinnati Bell settled by paying its customers more than two million dollars, plus the class's attorney's fees. *(cont'd)*

customer's money. Instead, it went directly to the CMRS Board, raising its good faith dispute and asking for a refund for taxes it believed it had paid in error.

The CMRS Board mistakenly relies on *CMRS Board v. TracFone Wireless, Inc.*, 712 F.3d 905, 916 (6th Cir. 2013), in support of its claim that good faith is not relevant to an award of attorney's fees here. That case is distinguishable in at least one respect very significant to the matter of attorney's fees. Unlike Virgin Mobile, TracFone challenged the collection of the 911 tax *after* the 2006 amendments made the CMRS Act expressly applicable to prepaid services. Indeed, the court noted that "TracFone is the only prepaid provider that has refused to remit fees under the 2006 Amendments." *Id.* at 911. The appellate court expressly affirmed the attorney's fee award based on this point:

> Despite the fact that the statute unambiguously applied to TracFone and that TracFone and its customers have benefitted from the enhanced 911 services, TracFone argues that it should not have to pay the fees it has owed since the effective date of the 2006 amendments. . . . Because TracFone was undoubtedly on notice that it had a duty to collect fees under the 2006 Amendments, it is responsible for remitting those fees now to the Board.
>
> For the foregoing reasons, the district court's judgment as to the award of fees owed under the 2006 amendments is affirmed, as is the award of attorneys' fees to the Board.

Id. at 916.

(cont'd from previous page)

Permakil Pest Control, Inc. and D. Brian Richmond v. Cincinnati Bell, Case 2:07-cv-00097-WOB (E.D. Ky., Northern Division) [Docket No. 58]. In 2008, BellSouth Telecommunications refunded more than $8 million to Kentucky customers to settle a similar lawsuit. *Clark v. BellSouth Telecommunications, Inc.*, 2007 U.S. Dist. LEXIS 87138 (W.D. Ky. Aug. 14, 2007) (full refund in case where carrier passed through tax at the insistence of the Kentucky Dept. of Revenue, but without statutory authority to have imposed the "unlawful" Internet sales tax).

Further, in awarding attorney's fees, the district court found only that TracFone has "some reasonable grounds for believing that its actions were appropriate," and that the award was not based on a finding of "bad faith." *CMRS Board v. TracFone Wireless, Inc.*, 2011 WL 4007668, at *2 (W.D. Ky. Sept. 8, 2011). These facts and findings do not implicate the "good faith" rule. *TracFone Wireless* is a far cry from the Court of Appeals' finding here that the lower court abused its discretion based on Virgin Mobile's "good faith" in challenging the pre-2006 CMRS Act and in attempting to resolve that dispute with the CMRS Board directly. Indeed, the sheer amount of the fee award at issue in *Tracfone Wireless*, totaling over $400,000, in comparison to the much more modest amount of attorney's fees at issue here, less than $150,000, further demonstrates the good faith of Virgin Mobile's targeted challenge.

The CMRS Board's ironic suggestion that Virgin Mobile did not act in good faith because it did not immediately file a declaratory judgment or seek an opinion from the Kentucky Attorney General should be rejected out of hand. Rather than lead with a lawsuit, Virgin Mobile notified the CMRS Board promptly in a good faith effort to discuss and resolve the dispute. "Good faith" cannot reasonably mean that a party must immediately file suit rather than attempt to work with the administrative agency to determine whether there is a dispute, its scope, and whether resolution without court intervention is possible.

C. THE CMRS BOARD REBUFFED VIRGIN MOBILE'S GOOD FAITH EFFORTS.

The CMRS Board did not take kindly to Virgin Mobile's queries. Indeed, the Court of Appeals found that "when Virgin Mobile made an attempt to discuss payment of the fee with the Board, *it was rebuffed.*" (Op. at 30 (emphasis added)). In hindsight, this

reluctance is easy to understand. The CMRS Board had *itself* questioned the application of the pre-2006 CMRS Act to prepaid wireless services, as early as 1999. (Lucas depo. 58, Exs. 6, 9 at 4). The Board also twice considered seeking the opinion of the Attorney General as to the applicability of the CMRS Service Charge to prepaid, and both times decided not to do so. (Lucas depo. at 98, 109, 116-21, Ex. 15 at 2 and Ex. 23 at 3). Given its own internal questioning, it can reasonably be presumed that the CMRS Board chose not to seek guidance from the Attorney General because it feared an adverse opinion.

In criticizing Virgin Mobile for not seeking an opinion from the Attorney General itself, the CMRS Board ignores the reality that it, not Virgin Mobile, was far more likely to successfully obtain an opinion on the issue. The CMRS Board has standing to request such an opinion. *See* KRS 15.025 ("The Attorney General, when requested in writing . . .shall furnish such opinions subject to the following conditions: (1) When questions of law of interest to the Commonwealth are submitted by a state department, agency, board of commission"). In contrast, a request by a private party such as Virgin Mobile is granted only "[w]hen, in the discretion of the Attorney General, the question presented is of such public interest that an Attorney General's opinion on the subject is deemed desirable and when provided for by regulation pursuant to the provisions of this section." *Id.* 15.025(4). Further, the regulation referenced provides that the Attorney General will *not* issue an opinion requested by a private party "in response to questions involving matters being litigated or questions submitted in contemplation of litigation." 40 KAR 1:020, § 4. Practically speaking, the Attorney General rarely issues opinions to nongovernmental requesters. *See* OAG 97-1, 1997 Ky. AG LEXIS 378 ("This opinion is

rendered pursuant to KRS 15.025(4). It is true this Office *rarely* renders opinions under this statute.") (emphasis added). In light of this, private parties generally work with the applicable governmental agency to have it file the request for an opinion – here, that would be the CMRS Board.

Yet faced with Virgin Mobile's repeated efforts to open a dialogue to resolve this dispute, the CMRS Board did not respond with any official board action. The Board held no vote, took no action, and neither sought nor issued any rule or opinion on the issue. Instead, its executive director simply issued a flat denial on his own, leaving Virgin Mobile without guidance or any reasonable explanation for the result. The only official response from the CMRS Board was the filing of this lawsuit. None of the authority cited by the CMRS Board supports an award of attorney's fees in such circumstances. More importantly, it would be inequitable to reward the CMRS Board for such conduct through an award of attorney's fees.

The Court of Appeals' ruling will not have any chilling effect on the CMRS Board's collection efforts under the CMRS Act. Rather, it will encourage the CMRS Board to engage in good faith to resolve taxpayers' disputes, rather than simply rebuffing them, and to seek guidance from the Attorney General when faced with complicated, genuine questions of statutory application before filing a lawsuit.

D. Virgin Mobile's "Good Faith" Is Relevant To the Attorney's Fee Analysis.

The CMRS Board cannot defend its position that "good faith" is irrelevant here. The CMRS Board asserts that attorney's fees should be analyzed differently than the taxpayer interest or penalties at issue in *Thomas* and *CNOTP*, making the "good faith" rule discussed in those cases inapplicable. (CMRS Br. at 13-14). This purported

distinction is based on a characterization of attorneys' fees as "compensation" for the prevailing party, rather than as a "penalty" against the losing party. But this argument simply tries to elevate form over substance. Statutory interest can just as easily be characterized as "compensation" for the loss of the time value of money, yet interest awards are subject to a "good faith" analysis. The CMRS Board offers no authority or substantive justification for such a distinction in the isolated context of attorney's fees.

In any event, Kentucky courts have equated an award of attorney's fees with a penalty. *See, e.g., Burns v. Shepherd*, 264 S.W.2d 685, 686 (Ky. 1954) (analyzing a case which "provided a penalty, including attorney fees" for failure to pay loss under policy in requisite time period); *Eplion v. Burchett*, 354 S.W.3d 598, 604 (Ky. App. 2011) (noting that plaintiff believed he was "entitled to imposition of the penalty" which included attorney's fees); *Jones v. Dougherty*, 2012 WL 6213723, at *3 (Ky. App. Dec. 14, 2012) (opinion not final and not authority) (noting that "the penalties for failure to comply with the provisions [of the statute] run from assessing attorney's fees to dismissal of the appeal"); *Ayers v. Duckworth*, 2008 WL 2152241, at *3 (Ky. App. May 23, 2008) (unpublished)[6] (holding that if a party "could show that it had a reasonable foundation for delaying the payment of the claim, then it may avoid the penalties of interest and attorney's fees."). This characterization makes more sense because a civil "penalty" is nothing more than a monetary consequence for a certain course of conduct beyond actual damages for the injury at issue. Accordingly, the Court of Appeals correctly found that assessing attorney's fees against Virgin Mobile in the circumstances constituted an

[6] This opinion is cited and a copy is attached as an exhibit hereto in accordance with CR 76.28(4)(c).

unwarranted "penalization." (Op. at 31). Finally, as we have seen, any award of statutory attorney's fees to the government from a good faith appellant is subject to Constitutional protection. *Slack*, 39 S.W.3d at 809, 813.

Penal statutes must be strictly construed against the government. *Ky. Registry of Election Fin. v. Blevins*, 57 S.W.3d 289, 292 (Ky. 2001). Moreover, unlike the mandatory penalty statutes in *CNOTP* and *Thomas*, the language of KRS 65.7635(5) is permissive. As such, the threshold for penalizing Virgin Mobile under the fee-shifting statute should be even higher. But the trial court ignored the permissive language entirely, stating "K.R.S. 65.7635(5) provides for an award of reasonable costs and attorney's fees." [June Order at 2] In any event, such statutes should not be stretched merely to goad companies into obedience with questionable agency policy. *Cf. The Ben R.*, 134 F. 784, 787 (6th Cir. 1904) (refusing to extend penal statute because "the rule in respect of the construction of penal statutes does not justify the extension of such a statute to a subject not embraced by words simply upon the doctrine that the case omitted is within the spirit or policy of the law."). Accordingly, failing to frame the fee request against either the permissive text of this penal statute or the context of the legal dispute was unfair to Virgin Mobile, and was an abuse of discretion.

Next, the CMRS Board argues that "good faith" is irrelevant because KRS 65.7635(5) does not expressly refer to "good" or "bad" faith as a condition to or limitation on recovery of attorney's fees. (CMRS Br. at 17). This argument ignores the fact that the statutes at issue in *Slack*, *Thomas*, *CNOTP*, and *Meyers* did not contain such express references either, yet the "good faith" rule was applied. The fact that some statutes expressly condition recovery on whether one of the parties acted in "good" or

"bad" faith does not mean that a court cannot consider a party's good or bad faith conduct in any case involving a statute without such conditions.

Finally, the cases cited by the CMRS Board do not support its assertion that "good faith" is only relevant in determining whether a prevailing *defendant* is entitled to recover attorney's fees from a plaintiff who brought its claim in "good faith." (CMRS Br. at 17-18). If a plaintiff's good faith assertion of a claim can preclude a prevailing defendant (who was involuntarily summoned to court) from recovering its attorney's fees, then a defendant's good faith assertion of a defense can preclude a prevailing plaintiff in the same manner. Indeed, the application urged by the CMRS Board would unreasonably and unfairly benefit the government at the expense of taxpayers, raising potential constitutional concerns. *See Burns v. Shepherd*, 264 S.W.2d at686-88 (finding that statutory provision violated federal and state constitutions because "its practical application it does nothing more than benefit one class of individuals at the expense of another"); *Slack*, 39 S.W.3d at 809, 813 (citing *Burns* and condemning an attorney's fee statute applied to punish employer who brought an appeal in good faith as "a pure act of arbitrary power that violates *Section 2 of the Kentucky Constitution*"). Taxing statutes cannot fairly be applied such that the taxing authority can assert collection claims without fear of liability for attorney's fees so long as they are engaging in the dispute in good faith, while denying that same good faith protection to taxpayers subjected to such claims. That is especially important here, where the fee statute applicable to a taxpayer applies only to actions brought against them, not against wireless providers that merely collect taxes. KRS 65.7635(2) only refers to collection actions against "CMRS customers" sued by the state.

II. ALTERNATIVELY, THE CIRCUIT COURT ABUSED ITS DISCRETION BY AWARDING STATUTORY ATTORNEY'S FEES NOT AUTHORIZED IN THIS CASE.

The lower court erred in assessing attorney's fees under KRS 65.7635(5) because that provision, by its terms, affects CMRS providers that fail to *remit* taxes they collect – that is not what happened here. Although the Court of Appeals concluded that the provision could have allowed attorney's fees—while denying them for other reasons—this Court may affirm the Court of Appeals' reversal on any correct ground. *See Fisher v. Fisher*, 348 S.W.3d 582, 591-92 (Ky. 2011).

The first sentence of KRS 65.7635(5) defines the timely remittance of CMRS service charges actually collected. The lower court ignored that sentence when it concluded without analysis that: "KRS 65.7635(5) provides for an award of reasonable costs and attorney's fees to be awarded in such collection actions." [June Op. at 2 (emphasis added)]. The Court of Appeals accepted that conclusion without further analysis, reversing the lower court on other grounds. But this bare conclusion as to the statute's effect implies a broader, clearer grant than the General Assembly actually provided. KRS 65.7635(5) concerns only timing issues for wireless providers that bill the 911 fee to customers and collect the money, but then refuse or fail to turn it over to the state in a timely manner. It states in relevant part:

> All CMRS service charges imposed under KRS 65.7621 to 65.7643 collected by each CMRS provider . . . are due and payable to the board monthly and shall be remitted on or before sixty (60) days after the end of the calendar month. Collection actions may be initiated by the state, on behalf of the board, in the Franklin Circuit Court or any other court of competent jurisdiction, and the reasonable costs and attorneys' fees which are incurred in connection with any such collection may be awarded by the court to the prevailing party in the action.

KRS 65.7635(5) (emphasis added).

By its plain language this second sentence is aimed at deterring conversion of monies already collected from the taxpayer customers and in the possession of the intermediary tax collector provider. As such, it serves an important purpose. If a CMRS provider fails to remit the revenue actually *collected* from a customer within sixty days, the state may sue to recover those collected funds, along with reasonable costs and attorney's fees. Here, however, there were no CMRS service charges collected from customers – there are no "collected" service charges to remit or recover, and therefore no basis for an award of fees. Since Virgin Mobile was not engaged in the conduct actually described by the statute, *i.e.* failure to timely remit taxpayer's funds in its possession or outright conversion, the fee shifting language relating to costs and fees simply does not apply.

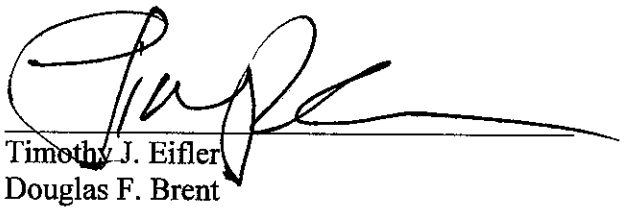
The lower court compounded its error by failing to construe the penal language of this tax statute strictly against the government taxing authority. In *Daly v. Look*, Kentucky's highest court said that attorneys' fees "may reasonably be said to be part of the penalty for violating a public regulation." 267 S.W. 2d 77, 79 (Ky. 1954). But statutes that are penal in nature are to be strictly construed. *Caudill v. Judicial Ethics Comm.*, 986 S.W.2d 435, 438 (Ky. 1999) (Stephens, J., concurring). The lower court abused its discretion in awarding attorney's fees under this provision, and that award was properly reversed.

CONCLUSION

For the foregoing reasons, in the event this Court affirms the Court of Appeals' judgment regarding the CMRS service charge claim at issue in *Virgin Mobile U.S.A., L.P. v. Commonwealth of Kentucky*, No. 2012-SC-000621, such that this appeal becomes ripe for decision, the Court of Appeals' reversal of the award of attorney's fees against Virgin

Mobile below should be affirmed. Alternatively, if the Court reverses the Court of Appeals' judgment on the 911 service charge issue, this appeal should be dismissed as moot.

Respectfully submitted



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